BRIEFING

European Parliament

Public hearing with Elke König, Chair of the SRB Supervisory Board, presenting the SRB Annual Report 2017

ECON on 11 July 2018

This note is prepared in view of a regular public hearing with the Chair of the Supervisory Board of the Single Resolution Board (SRB), Mrs Elke König, who will inter alia present the SRB Annual Report 2017. The EP received a copy of that report on a confidential basis, under embargo until the presentation of that report. In view of that restriction, this briefing does not refer to the Annual Report in any way.

The following issues are addressed in this briefing: (i) resolution financing, including the recently agreed backstop to the Single Resolution Fund (SRF) and considerations by the Eurogroup on further "work on a possible framework for liquidity in resolution, including on the possible institutional framework"; (ii) whether further harmonisation of insolvency law is necessary to complete the Banking Union ; (iii) an update on resolution cases (Banco Popular, ABLV, and Cyprus Cooperative Bank); (iv) current achievements in terms of the SRB's work programm; (v) recent events concerning the SRB, and (vi) external briefing papers on the topic of "valuation reports".

I. Resolution financing

The Single Resolution Fund

The SRF amounts to EUR 25 bn by end June 2018. The ultimate size of the SRF (1% of covered deposits) that was initially estimated at EUR 55bn has been reassessed by the SRB to probably achieve EUR 60 bn, given the increase of deposits in Banking Union banks. The SRF has been established for the purpose of both i) absorbing losses and compensating creditors and ii) providing liquidity in resolution.

The agreement reached among the Eurogroup on the "backstop" to the SRF (see table 1) keeps the amount that the ESM may use for resolution essentially unchanged: The ESM currently reserves a maximum of EUR 60 bn for its Direct Recapitalisation Instrument ('DRI'). Since the backstop would replace the DRI, the ESM will by and large keep the same amount earmarked for resolution, but will shift its focus from solvency support ('recapitalisation') to the provision of both liquidity and 'loss absorption' by the SRF.

With respect to the **size of this backstop**, the Chair of the SRB took the view in an interview to the German press in June 2018 that "*she can live*" with a backstop of EUR 60 bn that will double the size

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of the SRF. At the same time, reflecting on the Banco Popular case, the SRB questioned whether the SRF could provide enough liquidity to address funding shortfalls. According to the financial press, Santander provided more liquidity than the SRF could have done[1], highlighting the need to find a solution when a buyer cannot immediately be found. While acknowledging that the "*SRF can play a role [in resolution financing], in particular if a back stop is in place*", Elke König noted in a conference in April 2018 that ***"this will always be too little for any systemic bank***". By way of example, the banking group Hypo Real Estate, which run into trouble when it could no longer tap into the interbank market that collapsed in the financial crisis, needed liquidity guarantees amounting to EUR 145 bn.

Table 1: "Landing zone on the common backstop to the SRF" (Annex to the Eurogroup letter)

General characteristics	• The ESM will provide the common backstop, in the form of a revolving credit line • The size of the credit line will be aligned with the target level of the SRF • The Direct Recapitalisation Instrument[2] should be replaced by the common backstop No country should be excluded from accessing the backstop
Modalities	• Fiscal neutrality • Maturities: 3 years plus possible 2 years extension • Equivalent treatment would be ensured with non-euro area Member States participating in the Banking Union, via parallel credit lines to the SRF
Decision making arrangements	• ESM BoD could take decisions on the use of the common backstop, arrangements with procedures in place for swift and efficient decision making whilst respecting national constitutional requirements • Option to be developed further in second half of 2018
Early introduction	• Common Backstop would enter into force ahead of 2024 if sufficient progress is achieved in risk reduction measures • Technical work, including on a possible revision of the IGA, to continue in the second half of 2018

Toward a new Resolution Facility to finance banks under resolution?

Further to the resolution of Banco Popular (see EGOV briefing), a debate has emerged as to whether an additional liquidity facility should be available to finance banks in resolution. Since the last hearing, this policy debate has gained additional momentum with the committment of the Eurogroup in June 2018 to work on this issue and with options discussed at the ECB regarding a possible Eurosystem Resolution Liquidity framework, along the lines of the Bank of England's Resolution Liquidity Framework.

[1] The financial means of the SRF are capped to the sum of the ex-ante contributions and ex-post contributions that the SRF may raise (ex post contributions shall not exceed per year three times the annual amount of ex ante contributions). When those financial means are not available, the SRB may resort to "alternative funding means" (e.g borrowing from financial institutions).

[2] The DRI has been introduced in December 2014. DRI may be used in very specific circumstances to directly recapitalise financial institutions, as a last resort instrument when all other instruments, including bail-in as mandated by the BRRD, have been applied and after the Single Resolution Fund (SRF) has been used.

The related working papers from both the Eurogroup and the ECB have not been made public. According to the financial press, rules governing the provision of a Eurosystem Resolution Liquidity that are being discussed include the following:

- The bank has been declared "failing or likely to fail" and the resolution scheme has been adopted by the SRB. Benoit Coeuré, Member of the ECB executive board further explained that the bank should be "*financially sound so if we know that the outcome of the resolution will be liquidation then of course we shouldn't provide central bank liquidity*",
- The bank is formally still eligible as counterparty for Eurosystem[3] monetary policy operations;
- The Eurosystem should benefit from a public-sector guarantee at European level covering the amount of liquidity provided to the bank via ERL;
- The Eurosystem should receive a remuneration set equal to the rate of the marginal lending facility as a minimum and could demand a mark-up.

At the ECON April hearing, Vitor Constancio explained that the European Central Bank needs a way to finance failing banks while they are being resolved, quoting the British and U.S. models as examples: "*The UK and U.S. have [...] a solid, whole process of resolution that includes those liquidity problems during that period of time, and I hope that Europe will get to some solution to this problem*".

The Bank of England's objective is to provide liquidity "*in the necessary scale*" and "*for a sufficient period of time*" to allow the firm to make the transition to market-based funding. The government has sole responsibility for authorising liquidity support via the resolution liquidity framework. Losses incurred by the Bank of England or the Treasory in connection with the Resolution Liquidity Framework (RLF) have to be recovered from the banking industry, in line with FSB principles and requirements in the Bank Recovery and Resolution Directive (BRRD.

The RLF is described by the Bank of England as a "flexible" tool that supplements the Sterling Monetary Framework. The RLF may be secured against a wide range of collateral, building on the collateral eligible in Sterling Monetary Framework operations. The terms, costs and conditions of liquidity support are designed according to the Bank of England "*in a way to support the effectiveness of the resolution regime, incentivise the transition of the firm back to market-based funding, and protect public money*".

In its paper on valuation commissioned for this hearing (See Part VI of this briefing), M. Hellwig stressed that "the lack of provisions in the BRRD and SRM Regulation for funding in resolution is a a majoir reason why time pressure is so strong in the European Unon, unlike the United States, where the FDIC can obtain interim funding by borrowing from the Treasory".

For further information, please see a separate EGOV briefing on the financing of banks under resolution.

II. Harmonisation of insolvency law

The SRB has recently pled for further harmonising insolvency law for banks. In April 2018, the SRB stressed that "*the divergence of national insolvency laws is a major obstacle towards a fully-fledged Banking Union*". As part of the SRM review due by 31 December 2018, the Commission shall "*evaluate the necessity of taking steps order to harmonise insolvency proceedings for failed institution*".

For the Chair of the SRB, further harmonisation of insolvency law for banks would present the following key advantages:

[3] As explained in Y. Meersch's speech, "counterparties to Eurosystem credit operations must fulfil certain eligibility criteria. In essence, an entity must not only be a licensed credit institution or a branch but also needs to be financially sound".

- Creating a level-playing field across Member States in terms of investors' protection under the no-creditor-worse-off principle: "*The divergence of national insolvency laws is a major obstacle towards a fully-fledged Banking Union. In the current system, the counterfactual of no-creditor-worse off (NCWO) might produce different results in different countries depending on the national insolvency regime and thus negatively impact on the orderly wind-down of a bank. The SRB therefore strongly encourages legislators to harmonise national insolvency laws, in order to create a level-playing field*".
- Facilitating resolution planning across the Banking Union so as to allow for a group-approach to resolution as opposed to a legal entity-by legal entity resolvability assessment: "*In the current framework insolvency is clearly entity-specific as is NCWO. It is crucial to bear in mind that without statutory or at least contractual changes to this framework, the focus during the resolution of banking groups will have to remain at entity level and thus limit the scope of national or cross-border waivers. In this domain, the legislators are clearly in the driving seat";*

That debate goes actually back to the creation of the Banking Union: In 2010, the Commission's communication on crisis management that presented a roadmap for an integrated resolution framework (EU Authority and EU resolution fund) suggested the adoption of a dedicated bank insolvency framework. In that communication, the EU Resolution framework (later: BRRD) was seen as a first step of a more integrated approach. The Commission suggested at that time to complement the first step by an insolvency framework (medium term or second step) and an integrated framework (longer term or third step) that involved an EU authority and an EU resolution fund. In the Commission's view, the second and third step were closely intertwined, pointing out that: "*the operational capacity of an EU resolution authority would depend on the establishment of an insolvency regime for banks*".

For further information, please see a separate EGOV briefing on harmonising EU insolvency laws.

III. Update on resolution and liquidation cases

Follow-up to the resolution of Banco Popular

Further to the resolution of Banco Popular on 6 and 7 June last year (see EGOV briefing), the SRB has announced on 13 June that it is taking steps to complete the **valuation 3** (see Table 2). Deloitte has already provided its final valuation 3 report, which is confidential. The SRB plans to publish a non-confidential version of that valuation report soon after mid-July (non-confidential versions of valuation 1 and valuation 2[4] have already been published; as regards the purpose and sequencing of the valuation reports, see table 2).

The external briefing papers on valuation reports have pointed to difficulties that valuation 3 may come across (see Part VI of this briefing). In particular, M. Hellwig considered that '*the counterfactual of what an insolvency procedure would imply for creditors is difficult, perhaps even impossible, to ascertain*". Against that background, M. Hellwig recommends to carry out the valuation 3 in ex ante terms, as of the time of the resolution decision.

Regarding the **disclosure of information** related to cases, the SRB's appeal panel has declared in June 2018 that the SRB's stance on public access to documents in the case of failed Spanish bank Banco Popular must be partly amended.

[4] Valuation 2 assessed Banco Popular' equity as lying between EUR 1,3 bn and EUR - 8,3 bn with a best estimate of EUR - 2,0 bn, according to FROB. On the basis of that valuation, the SRB wrote down the equity and additional tier one instruments, while the tier two instruments were converted into shares before the shares were transferred to Santander. Additional tier one and tier two instruments amounted to EUR 2 billion in total.

Table 2 - Types of Valuations under the BRRD

Type	Purpose	Time to be Performed	Valuer	Legislative Grounding
Valuation 1	Decide Resolution	Before resolution action, when the authorities perceive a potential crisis situation	Independent Valuer	Art. 36(1) of the BRRD
Valuation 2	Determine the applicable tools	After having ascertained the conditions for resolution are met (also through Valuation 1)	Independent Valuer	Art. 36(1) and 36(4) of the BRRD
Valuation 3	Confirmation that the 'no creditor worse off' principle is observed	After the exercise of the resolution action	Independent Valuer	Art. 74 of the BRRD

Source: Lastra and Olivares Caminal, July 2018

ABLV

The decision not to resolve ABLV that the SRB took on 24 February 2018 (see EGOV briefing on recent cases on Anti-money laundering) resulted in two conflicting decisions in Latvia and in Luxembourg where a subsidiary of ABLV was established:

- The shareholders of ABLV decided at an extraordinary meeting on 26 February 2018 to voluntary liquidate the bank
- On 9 March 2018, the Luxembourg Commercial Court, however, decided to refuse the request to place the subsidiary in Luxembourg – ABLV Bank Luxembourg, S.A. – in liquidation. That entity is now being sold to new investors.

In terms of proceedings, the following happened since the last hearing:

- On 12 June 2018, the Latvian authority in charge, the Financial and Capital Market Commission (FCMC) permitted ABLV Bank to implement voluntary liquidation plans under the control of FCMC. The operation will be steered by the new executive body of the bank – the Liquidation Committee, which consists of four liquidators approved by the FCMC.
- In May, ABLV filed lawsuits against the ECB and the SRB. In accordance with BBRD, the lodging of an appeal shall not entail any automatic suspension of the effects of the challenged decision. Decisions of resolution authorities are immediately enforceable.

Box 1 - ABLV statement regarding the decisions of the ECB and the Luxembourg Court

"The decisions of the European Central Bank (ECB) seem to have been taken for all entities of the ABLV group regardless of their specific situation and quality. ABLV Bank Luxembourg, S.A. has an extremely strong excess capital (the capital adequacy ratio of more than 29% versus the legal requirement of 10.5%), a very high liquidity (the LCR of 383% versus the legal minimum requirement of 100%), no bad loans, and a very limited reliance on the group. The Luxembourg court considered the specific situation of the Luxembourg entity and overruled the decisions of the ECB based, amongst other, on the very strong financial standing of ABLV Bank Luxembourg, S.A., a result of its sound management".

Both the SRB and SSM Chairs called for further harmonisation of national insolvency law as a consequence of the ABLV case:

- At the last ECON hearing, Elke König emphasised that the ABLV case highlighted "*the importance of harmonising banks' insolvency laws. The common SRM framework for resolution is faced with 19 or more different insolvency procedures. The failing or likely to fail (FOLTF) assessment does not automatically link to the criteria for insolvency/liquidation. Only by raising national bank insolvency procedures to a common standard we can clarify the line between resolution and insolvency and eliminate wrong incentives*";
- In the same vein, at the 26 March ECON hearing, Danièle Nouy, chair of the SSM, suggested making it clear in the BRRD that absent a 'public interest' underpinning resolution measures as determined by the SRB, banks would need to be liquidated under national insolvency law and not resolved.

In addition, the Luxembourg court decision illustrates that the liquidation process for a banking group with legal entities in more than one Member State leads to the application of different national insolvency law frameworks. In that respect, the ABLV case raises the issue as to whether insolvency proceedings need to be coordinated when it comes to the liquidation of a group that is active in several Member States. The 2009 Commission communication on cross-border crisis management noted that '*as a minimum [...] an EU bank resolution framework should be supported, by a binding framework for cooperation and exchange of information between courts and insolvency practitioners responsible for proceedings relating to affiliated entities in a banking group*".

For further information, please see a separate EGOV briefing on harmonising EU insolvency laws.

Cyprus Cooperative Bank

On 19 June 2018, the Commission approved the **liquidation of Cyprus Cooperative Bank** (CCB), involving a sale of assets and deposits to another Cypriot bank, Hellenic Bank. The transaction removes around EUR 6 billion of non-performing loans from the Cypriot banking sector.

The liquidation measures, approved under State Aid rules, mark the final steps in the restructuring process of CCB, which was initially started in February 2014 and modified in December 2015.

Contrary to expectations at the time, CCB – the second largest credit institution in Cyprus – was **unable to return to viability**: it failed to recover sufficient payments from its significant portfolio of non-performing loans (NPL ratio of 57% as of February 2018), due to own governance failures and obstacles created by the Cypriot legal framework to work out non-performing loans. A sale process for CCB initiated on 19 March 2018 did not result in any bids at a positive price, all bids rather asked for additional State support. On 17 June 2018, the Cypriot authorities notified their plans to support the orderly liquidation of CCB by the sale and full integration of some of CCB's assets and deposits into Hellenic Bank, providing around EUR 3.5 billion to CCB to that end. CCB was entirely funded through deposits and it did not have any senior or subordinated debt.

As the restructuring of CCB started in 2014 before the BRRD entered into force, the process remained governed by Cypriot national law and EU State aid rules, and was managed by national authorities. The public support will finance the orderly market exit of the bank. CCB's residual entity will be entirely focused on working out its remaining assets. The Commission took its decision on the basis of significant binding commitments by Cyprus to reform its domestic legal and judicial framework, and will closely follow the developments as part of Cyprus' post-programme surveillance.

Pilatus Bank

Pilatus Bank is a less significant institution prudentially supervised by the Malta Financial Services Authority (MFSA). Pilatus Bank is authorised since 2014 as a credit institution providing private and corporate banking services to wealthy individual clients and financial institutions.

On 30 June 2018, the MFSA **asked the ECB to withdraw the banking license of Pilatus Bank** on the following grounds:

- Indictment of the Ultimate Beneficial Owner (UBO). In March 2018, Mr Ali Sadr Hashemi Nejad, the sole and ultimate beneficial owner (UBO) of Pilatus Bank was indicted in the United States "*for his alleged involvement in a scheme to evade U.S. economic sanctions against Iran, to defraud the U.S., and to commit money laundering and bank fraud*". As a result of that indictment, the MFSA has considered that "*it is no longer satisfied that the UBO is a suitable person as required by the Banking Act*". For further details on Pilatus Bank's alleged breaches of anti-money laundering ('AML') rules, see EGOV briefing on recent cases on AML;
- Liquidity. "The MFSA has been monitoring the bank closely and notes that the bank has been persistently breaching the liquidity coverage required by law since the indictment of the UBO".

The ECB has not taken its decision yet. A withdrawal of the banking licence would likely result in the liquidation of the bank under national insolvency proceeding. The ECB is responsible for withdrawing the authorisation of all credit institutions in the euro area (both significant and less significant institutions) in accordance with Article 14(5) of the SSM Regulation), inter alia, for anti-money laundering and anti-terrorist financing reasons[5].

Maltese authorities are currently under investigation by the European Banking Authority ('EBA') in relation to Pilatus Bank. Further to a request by the EP, the European Banking Authority ('EBA') opened a formal breach of union law investigation on 7 June 2018 over how Malta's Financial Intelligence Analysis Unit (FIAU) enforced anti-money laundering rules at Pilatus bank. The EBA also asked additional information to MFSA.

[5] According to the CRD Article 18(1), an authorisation may be withdrawn where a credit institution commits one of the breaches referred to in Article 67(1), which includes the circumstance whereby « an institution is found liable for a serious breach of the national provisions adopted pursuant to Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing.

IV. Where does the SRB stand in terms of resolution planning?

Resolution plans

The European Court of Auditors ('ECA') pointed in its Special report on the SRB, published in December 2017, to significant shortcomings regarding the substance and timing of the SRB's resolution planning, calling it "*still very much a **work in progress***".

The SRB's Multi-Annual Planning and Work Programme 2018 sets out the objective for 2018 to "*enhance resolvability inter-alia by drafting and adopting resolution plans for 99% of the groups under its responsibility*." (The most recent ECB's list and SRB's list of supervised entities contain 76 significant groups, 42 significants banks, and 13 other cross-border groups)

According to the Eurogroup report on risk reduction, the SRB has adopted 106 resolution plans for banking groups in 2017, saying "*[t]his means that 93% of the banking groups and subsidiaries under the SRB remit [...] are now covered by a resolution plan, even if in differing stages of maturity of the content*".

However, the judgement as to whether there is a meaningful advancement in terms of resolution planning depends on what **stage of maturity** the plans ought to have achieved, as the SRB prepares resolution plans in four phases (see box 1). The ECA's report highlights (p. 7) that at least in the past "*the plans adopted in 2016 did not meet a substantial number of requirements laid down in the Single Rulebook*". The Eurogroup report does **not detail the maturity**, whether the plans are complete (phase 4) or wheter they are still in previous phases.

A recent dispute between the SRB and a national resolution authority (see below) mediated by EBA seems to indicate that resolution plans in particular lack information on resolvability (See below).

Box 1 - Phases of resolution planning

Phase 1	Phase 1 plans or **transitional resolution plans** (TRP) focus on aspects of the strategic business analysis. They are not subject to approval by the SRB meeting in an extended Executive Session
Phase 2	Phase 2 plans are more comprehensive than TRPs and are subject to adoption by an extended Executive Session and are mainly for internal use
Phase 3	Phase 3 plans include a determination of the **MREL buffer at consolidated level**. They are sent to resolution colleges for a decision but do not include a determination of substantive impediments or MREL
Phase 4	Phase 4 plans include a determination of **substantive impediments** and **MREL at consolidated and single entity level**

Source: ECA report on the SRB, p. 17

EBA legally binding mediation decision on resolution planning

The way the SRB implements its 2017 resolution planning cycle gave rise to an EBA binding mediation decision in June 2018 to settle a disagreement between the SRB and the National Bank of Romania (NBR). The NBR requested the EBA to assist in settling a **dispute with the SRB concerning the adoption of resolution plans** for two banking groups, the underlying facts and issues were similar in both cases.

The EBA took the view that those resolution plans **did not satisfy the requirements of the BBRD**, according to which resolution authorities have to determine whether impediments to resolvability are 'material or substantive', and not just 'potential', as initially contemplated by the SRB. The SRB, however, did not concur with the EBA that "*material impediments to the resolvability' should be included in the 2017 resolution planning cycle as the resolution plan of the Groups define already a list of 'potential impediments*".

The ECA's report on the SRB points the same shortcoming (p. 27): "I*n none of the sampled documents did the SRB conclude categorically whether the bank could actually be resolved. While some chapters contained a brief summary of the assessment of resolvability, in most of them the summary was limited to a few of the identified potential impediments*."

MREL

According to its 2017 MREL policy published in December , the SRB takes an **incremental approach to MREL**:

- In 2017, the SRB moved from informative targets to bank-specific, binding consolidated MREL targets for the majority of the largest and most complex banks in the euro area, including all global systemically important institutions (G-SIIs). MREL at consolidated level applies to the parent entity for the group as a whole ;
- In 2018, the SRB is developing guidance on solo/internal MREL which banks that are part of a banking group (subsidiary) need to comply with;
- In 2018, the SRB will also work further on defining the need for subordination;

In terms of progress, the SRB mentiones in the June 2018 Eurogroup report that it has alreading set **binding MREL targets** at consolidated level for the **largest banks** representing 82.5% of the total banking assets in the Banking Union[6].

As regards the **level of compliance** with binding MREL targets, the report sets out that:

- 43% of those banks already meet their consolidated MREL target;
- 25% have a transition period set between 1-2 years;
- 11% have a transition period between 2-4 years;
- for 20% of the banks a transition period has not been set at this stage.

The Eurogroup report features a disclaimer pointing at data collection issues that reads "**Computations are based on data reported by banks as of 31 December 2016**." The current level of compliance may therefore be different from what is stated above.Anonymous and agreggated data in the Eurogroup shows **important differences among banks headquartered in different Member States**, some having significant MREL shortfalls[7].Again, it those aggregated data date back to end 2016. Those data do not allow for a proper assessment of the current situation.

Subordination requirement

Ahead of the adoption of BRRD II which implements the FSB TLAC standard[8], Global systemically important institutions (G-SIIs) are required by the SRB to meet a minimum subordination level equal

[6] According to ECB statistical data on the concentration of total assets (table T01.04), that would translate into binding MREL targets for approximately 25% of the banks under supervision.

[7] In particular 3 Member States (anoumsly referred to) have MREL shortfall above EUR 27bn.

[8] According to the FSB TLAC term sheet, the transition period to implement the TLAC standards is as follows: (i) From 1 January 2019 to 1 January 202, TLAC must be at least 16% of the resolution group's RWAs (13,5% where the option that allows non-subordinated instruments to count toward TLAC for an amount up to 2.5% of RWA is used) ; (ii) from 1 January 2022 onward, TLAC must be least 18% as from 1 January 2022 with an allowance of 3,5%. Those requirements do not include any applicable regulatory capital (Basel III) buffers, which must be met in addition to the TLAC RWA Minimum.

to 13.5% RWA plus the combined buffer requirement (CBR). For other SIIs, the benchmark is set at 12% of RWA plus the CBR. Those levels are likely to be changed as a result of on-going negotiations on the Banking Package. Looking forward, the SRB clarified that '*decisions on MREL will be regularly updated in the light of possible changes in the structures and degrees of riskiness of banks, as well as keeping up to date with potential regulatory developments*'.

From end 2017 to June 2018, 65% of the debt (EUR 226bn of debt including senior and subordinated contracts) issued by G-SIIs and O-SIIs in 13 Euro area has been issued in the form of 'senior unsecured debt' according to the SRB. Further to the adoption in France, Spain and Belgium of Senior Non Preferred laws, that increase in senior debt issuance witness the focus of banks on fulfilling TLAC (Total Loss- Absorbing Capacity) and MREL requirements.

V. Recent events concerning the SRB

Composition of the board of the SRB

On 19 March 2018, the SRB announced the appointment of Mr Boštjan Jazbec as Member of the Board and Director of Resolution Planning and Decisions. Mr Jazbec has been serving as Governor of the Bank of Slovenia and Member of the Governing and General Councils of the ECB since 2013. He replaces Ms Joanne Kellerman who announced her resignation in August 2017. The Commission proposed Mr Jazbec as a candidate to the EP which gave its approval on 21 February.

Composition of the SRB Appeal Panel

On 26 March 2018 and with immediate effect, Mr Yves Herinckx resigned as Vice-Chair of the Appeal Panel. On 17 April 2018, at an in person meeting in Brussels, the Appeal Panel elected its Member, Mr Luis Morais Silva, as Vice-Chair of the Appeal Panel and confirmed its Alternate Ms Helen Louri-Dendrinou, as a permanent Member.

The SRB Appeal Panel, composed of five members and two alternates, decides on appeals submitted against certain decisions made by the SRB, inter alia regarding the access to documents. It has recently received a significant number of appeals concerning the resolution of Banco Popular.

VI. External papers on valuation

At the request of the ECON Committee, three external papers have been commissioned to analyse the challenges of valuation reports in the context of banking resolution. The resolution of Banco Popular in Spain has shown the large degree of uncertainty (see above Part IV of this briefing - Update of resolution cases) that independent valuation carried out under time pressure may face. In terms of policy recommendations, the three paper present diverging views. While De Groen, Lastra and Olivares-Caminal are of the view that a moratorium tool may help reduce time pressure, Hellwig considers that a moratorium is likely to exacerbate the difficulties. For Hellwig, time pressure can only be alleviated effectively if the funding of banks under resolution is ensured, along the lines of the US FDIC, requiring legislative and institutional changes (see also Part I of this briefing). De Groen calls for further harmonising insolvency laws to facilitate valuation (see also Part II of this briefing). In terms of operational recommendations under existing arrangements, De Groen suggests a better access to information and IT system to speed up valuation.

1. Rosa María Lastra and Rodrigo Olivares-Caminal

In their paper, Lastra and Olivares Caminal emphasise that valuations are an important element in a bank resolution according to the BRRD that have to be performed at three different stages in the process: (i) Valuation 1 is relevant for the initial decision on the resolution, (ii) Valuation 2 shall help to determine the applicable resolution tools, and (iii) Valuation 3 shall inform whether the 'no creditor worse-off' principle[9] has been adhered to.

Lastra and Olivares-Caminal point out that the task of preparing those highly technical and complex valuation reports is made more difficult by the time constraints that characterise the pre-resolution context, where authorities are required to act quickly to avoid a bank run.

The authors consider that those **time constraints** as well as the existence of different valuation processes raises important issues in terms of legitimacy and accountability, which are linked to the complex institutional structure of the SRM. The need to produce highly technical reports (which would typically require six weeks) in a very short period of time is a major challenge in the resolution process under the BRRD. Given the litigious nature of some resolution actions and the different interests at stake, this is a fundamental issue for the credibility of the SRM.

Lastra and Olivares-Caminal are of the view that the introduction of a **moratorium** tool could address the issues of timing and flexibility in the valuation process. If one of the main reasons for the urgency of the resolution action is the risk of deposit outflows, a tool allowing for a temporarily liability freezing could enable the parties involved to have more time to prepare the valuations.

2. Martin Hellwig

In his paper, Hellwig finds that providing the valuation with more time may improve the information that is available, but points out that more time cannot eliminate the elements of subjectivity and arbitrariness inherent in the valuation of risks and of illiquidity of non-tradable assets.

Looking at options to reduce the time pressure, Hellwig specifically **warns against a moratorium**, arguing that a moratorium on payouts is likely to exacerbate the difficulties, as the anticipation of a moratorium may merely accelerate the run. More importantly, as regards systemically important institutions, a moratorium on payouts can cause severe damages to the overall financial system and the real economy. Hellwig reminds of the contagion effects that were observed when moratoria were used in the United States. Firms and other institutions with large, hence uninsured deposits, which rely on those deposits for their payments and their cash management, may find that their day-to-day activities are severely hampered by a moratorium, and the consequences for the real economy can be highly disruptive.

The time pressure could be significantly reduced, however, if the **problem of funding** was solved. For Hellwig, a run is only a symptom of a deeper problem, i.e. (the lack of) funding. Hellwig raises awareness to the fact that resolution takes time. During that time, whoever holds and manages the bank's assets needs funding. The BRRD and the SRM Regulation, however, do not provide for arrangements that would secure such funding.

Hellwig is convinced that without an assurance of sufficient funding, any reference to a strategy of holding and managing assets and any reference to the associated value is purely academic. If funding is not available, such a strategy is not feasible. If funding was available, however, Hellwig would consider the problem of depositor and creditor run to be harmless. Where funding is secured,

[9] The NCWO principle is a key principle of the BRRD that governs the protection of creditors whereby no creditor should incur greater losses than it would have incurred if the institution had been wound up under normal insolvency proceedings. This valuation shall determine the difference between the treatment of shareholders and creditors should normal insolvency proceeding had taken place in lieu of resolution and the actual treatment that the shareholders and creditors have received under resolution.

the resolution authority can take control of the bank and then decide which strategy to pursue. In the process, there would also be plenty of time for a more thorough valuation.

Hellwig hence **recommends a change in the legal framework** that would address the problem of funding in resolution. As an example, Hellwig refers to the situation in the US where funding is provided by the Federal Insurance Corporation (FDIC) which does not only have a fund of its own but can also obtain interim funding from the US Treasury. The arrangement enables the **FDIC** to take control of failing banks and then to dispose of them without worrying about funding, quickly or slowly, depending on which alternative seems more promising.

Finally, Hellwig emphasises that the **no-investor-worse-off principle is unclear** in the BRRD and the SRM Regulation: **On the face of it**, the standard of comparison for this principle is given by the **ex post outcome** under an insolvency procedure. That standard, however, is unrealistic because the ex post outcome under an insolvency procedure often cannot be known. Hellwig suggest that it might be more appropriate to formulate the assessment of what investors would have received in an insolvency procedure in **ex ante** terms, as of the time of the resolution decision.

Hellwig calls for a clarification, either by a suitable change in the BRRD and the SRM Regulation or by a delegated act of the Commission.

3. Willem Pieter De Groen

In his paper, **De Groen** also mentions the challenges resulting from time pressure and a lack of detailed information available to prepare the valuation, with a focus on the legal and economic challenges that valuation faces.

De Groen argues that **legal challenges** – non-harmonised national insolvency regimes and mis-selling issues – make it more difficult to come up with robust valuations, and that the disclosure practices might make the valuation contestable in court.

The **economic challenges** primarily involve predicting the impact of deteriorating conditions just before the resolution and credible estimations of the economic developments afterwards.

Conceding that there will always be some degree of uncertainty in the context of valuations, De Groen suggests that the following administrative steps **to improve the accuracy** of valuations, namely (i) improving the IT systems of the banks; (ii) granting the SRB as well as independent valuators access to information; (iii) increasing the use of historical data on previous bank failures; (iv) and shortening the procedures to select the valuator.

Like Lastra and Olivares Caminal, De Groen suggests introducing a moratorium to allow a short suspension of payments if necessary.

More fundamentally, De Groen calls for harmonising the insolvency regime for eurozone banks in a way that integrates both resolution and insolvency. In his view, that integration would provide the SRB with more flexibility to consider other interests than those of creditors (e.g. financial stability) in resolution, without risking claims under the no-creditor-worse-off principle. De Groen considers that founded claims are not unlikely under the current regime, in particular if the assessment of "failing-or-likely-to-fail" is based on future illiquidity, as most insolvency regimes require actual and present illiquidity to activate bankruptcy. De Groen therefore suggests a harmonised insolvency regime for banks that integrates the resolution mechanism in the form of a special chapter in the applicable insolvency laws.

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